



VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2016

Auditor of Public Accounts
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AUDIT SUMMARY

Our audit of the Virginia Small Business Financing Authority for the fiscal year ended June 30, 2016, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth's accounting and financial reporting system, and the Authority's internal loan accounting system and records;
- no matters involving internal control and its operation necessary to bring to management's attention; and
- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

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AUTHORITY HIGHLIGHTS

The Virginia Small Business Financing Authority (Authority) has been in existence since 1984 and provides financial assistance to Virginia-based businesses through bond issuances, direct loans, loan guarantees, and portfolio loan loss reserves as well as other technical assistance. The Governor appoints the Authority's 11-member Board of Directors.

The Director of the Department of Small Business and Supplier Diversity (Supplier Diversity) appoints the Authority's Executive Director, who oversees the Authority's operations. The Authority's staff, who are also Supplier Diversity employees, but paid entirely by the Authority's revenues, support the Authority by marketing the Authority's programs and services, reviewing program applications, conducting credit analyses, monitoring the progress of projects that have received funding, servicing loan receivables, administering the Authority's fund and bank accounts, and preparing the Authority's financial statements and reporting to state and federal funding sources. The Authority is included as part of Supplier Diversity's general fund appropriations; however, various fees and interest earnings cover the majority of the Authority's administrative expenses.

The exact nature and number of programs administered by the Authority have continually changed over time based on market need and funding resources available. The Authority's financing programs fall into three broad categories: bonds, direct assistance, and indirect assistance. This report will broadly discuss activity in these three categories below. For more information about the individual programs and financial activity of the Authority, please see the Authority's Financial Statements, which are located on Virginia's Legislative Information System website at www.lis.virginia.gov under the "Reports to the General Assembly" section.

Through the bond program, the Authority provides Virginia businesses and 501(c)(3) non-profits with access to low cost bond financing which they would otherwise not be able to obtain on their own. The direct assistance programs provide loans to qualified Virginia businesses and 501(c)(3) organizations, while the indirect assistance programs provide support to Virginia businesses through loan guarantees, cash collateral, and loan insurance programs. The goal of these programs is to encourage economic development through either job creation or retention by small businesses while striving to recapture public funds over time for future credit requests.

Bond Programs

The Industrial Development Bond Program is a financing vehicle in which the Authority serves as a conduit issuer of tax-exempt and taxable industrial development bonds for qualifying businesses and 501(c)(3) entities. The Authority also has the ability, through specific language in the Code of Virginia, to assist Virginia's transportation initiatives through the issuance of bonds for qualified private-sector companies working with the Virginia Department of Transportation in public-private partnerships. The nature of the entity and consideration of the Commonwealth's available allocation of private activity bonds determine whether or not the bond issuance will be tax-exempt.

The private sector provides the bond financing, not the Authority or the Commonwealth; and the respective small business or non-profit has responsibility for debt service. As such, the Authority takes

on no risk related to this program. The Authority is responsible for collecting application and administration fees associated with the bond issuances. These funds support the ongoing operating expenses of the Authority and also provide additional funding to other programs administered by the Authority. The Authority has facilitated the issuance of 174 bonds since the program's inception, including five bonds in fiscal year 2016 issued for a total of \$118,896,000.

Direct Assistance Programs

The following revolving loan programs provide loans, generally in amounts up to \$1 million, to bridge the gap between private debt financing and private equity or, in the case of the Microloan Program, to provide direct loans to fund very small business financing needs which banks sometimes prefer not to offer. As borrowers repay the loan principal and interest, the Authority uses the proceeds to issue new loans. The remaining interest earned supports the Authority's ongoing operating expenses.

- Federal Economic Development Loan Fund Program (EDLF)
- State Direct Loan Program
- Small, Women-owned, and Minority-owned (SWaM) Business Microloan Fund

Note: The Small Business Microloan Program was renamed the Small, Women-owned, and Minority-owned Business Microloan Fund effective July 1, 2015.

In addition to the economic development oriented loan programs described above, the Authority also administers two smaller direct assistance programs on behalf of other state agencies, which provide loans to specific types of businesses for restricted purposes and are listed below.

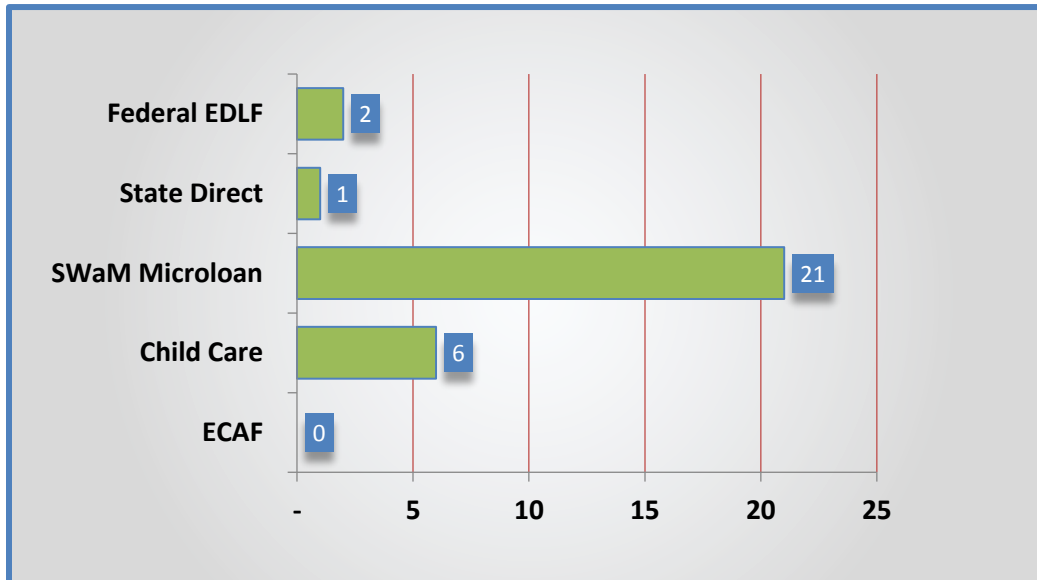
- Child Care Financing Program
- Small Business Environmental Compliance Assistance Fund (ECAF)

Note: The Authority administered this program on behalf of the Department of Environmental Quality (DEQ). The Authority has issued no new loans in this program since 2009, and as of December 2015 this program was discontinued and the remaining cash on hand was transferred back to DEQ. The Authority will continue to service the one outstanding loan remaining from this program, which matures in 2020. Cash collections on that loan will be transferred to DEQ semi-annually.

Charts 1 and 2 provide information on the dollar value and number of new loans issued by the Authority related to direct assistance programs during fiscal year 2016. In total, the Authority issued \$3,115,429 of new loans in fiscal year 2016.

Number of New Loans Fiscal Year 2016

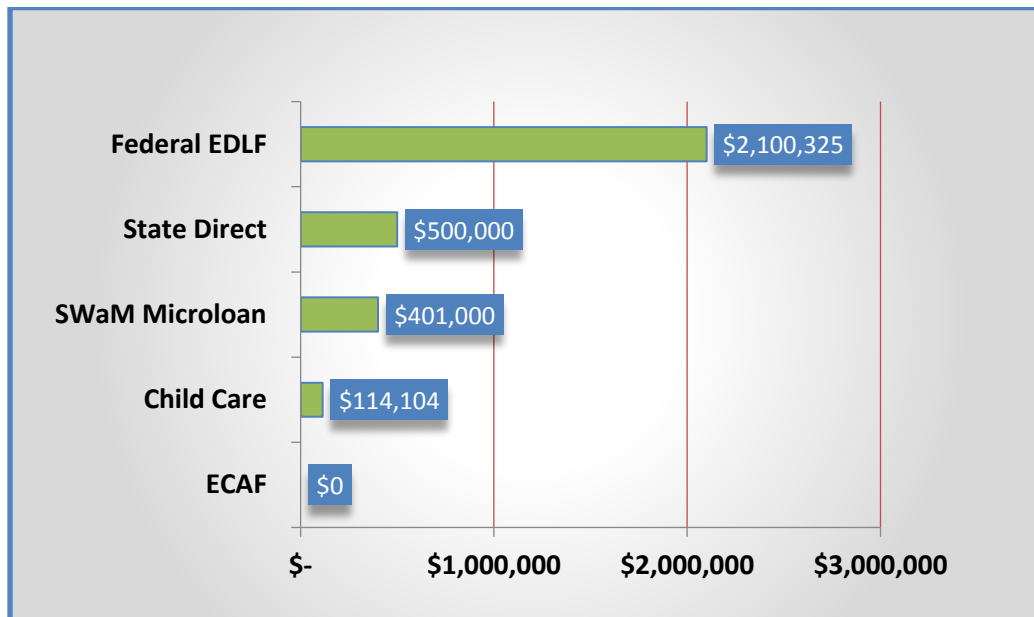
Chart 1



Source: Authority's Internal Loan Accounting System

Amount of Loans Disbursed Fiscal Year 2016

Chart 2



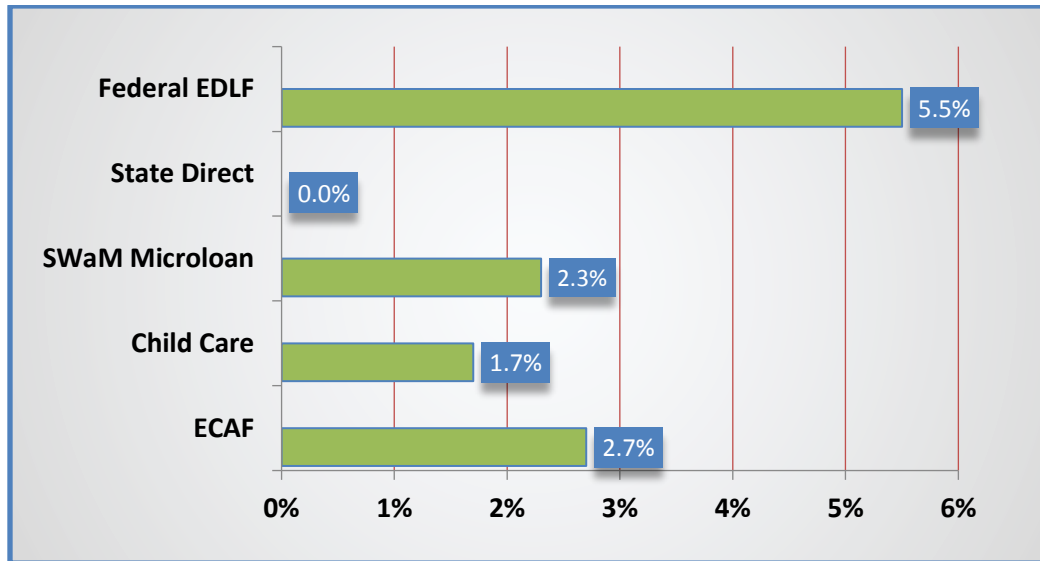
Source: Authority's Internal Loan Accounting System

Direct Assistance Program Default Rates

Default rates since inception for direct assistance programs remained constant or declined in fiscal year 2016, with the exception of the Federal EDLF Program, which experienced a one percent increase in its default rate since inception from 4.5 percent to 5.5 percent. The Authority performs the credit underwriting and approval of applicants for the direct assistance programs. For approved program participants, the Authority performs all loan closing, billing, accounting, reporting, and collection functions. The Authority works with both the bank and program participants to encourage timely payments. The Authority charges off loans when it can ascertain the amount of loss, or when a loan reaches a 120-day delinquency status and repayment appears highly unlikely. For non-bankruptcy cases, the Authority sends the loan to the Office of the Attorney General and to the Commonwealth's debt set-off program to facilitate collection. Chart 3 provides information on default rates since inception related to the Authority's direct assistance programs as of the end of fiscal year 2016.

Default Rates Since Inception for Direct Assistance Programs

Chart 3



Source: Calculated from Authority Internal Records

Indirect Assistance Programs

The Authority's various indirect assistance programs as listed below provide guarantees, cash collateral, and loan loss reserve insurance to banks to assist them in making loans to small businesses. These programs mitigate a bank's risk, which enables it to make more loans.

- Virginia Capital Access Program (VCAP)
- Tobacco Capital Access Program (TCAP)
- Loan Guaranty Program (LGP)

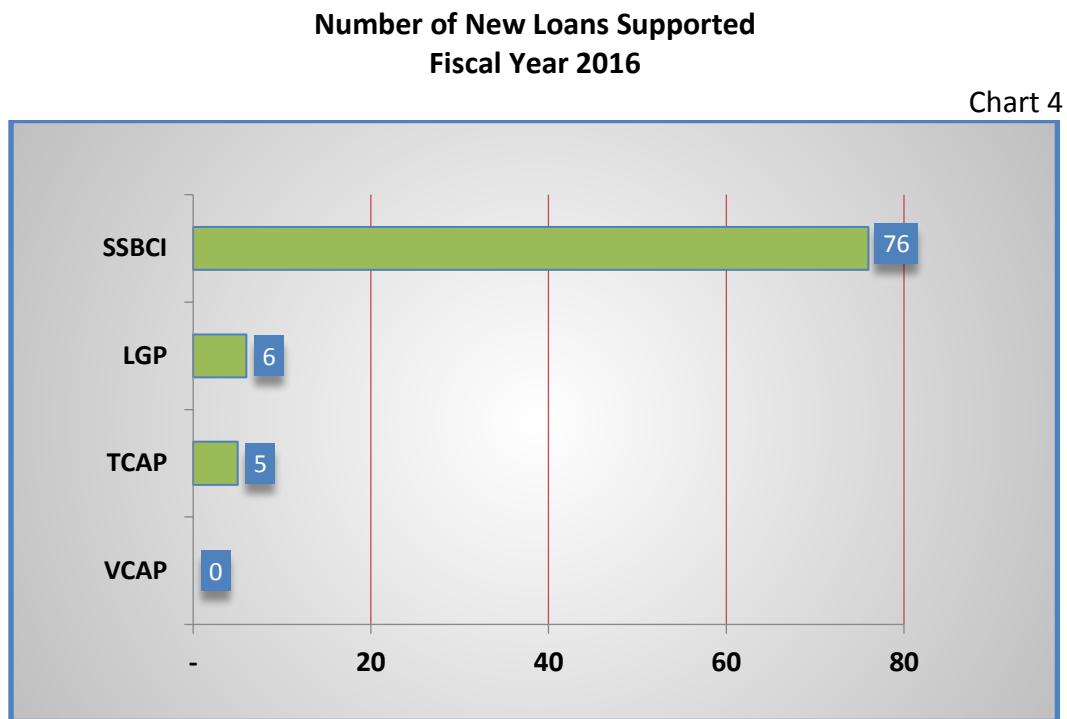
- Providing Access to Capital for Entrepreneurs (PACE) Program

Note: In September 2015, the remaining cash in this program was transferred to the Small, Women-owned, Minority-owned Business Microloan Fund.

- State Small Business Credit Initiative (SSBCI)

Note: Under SSBCI, federal funds for programs that leverage private lending are used to help finance small businesses in the interest of expanding and creating jobs. In total, the Authority has received \$17,953,191 in funding from the U.S Department of Treasury.

Chart 4 provides information on the number of new loans supported by the Authority related to indirect assistance programs during fiscal year 2016.



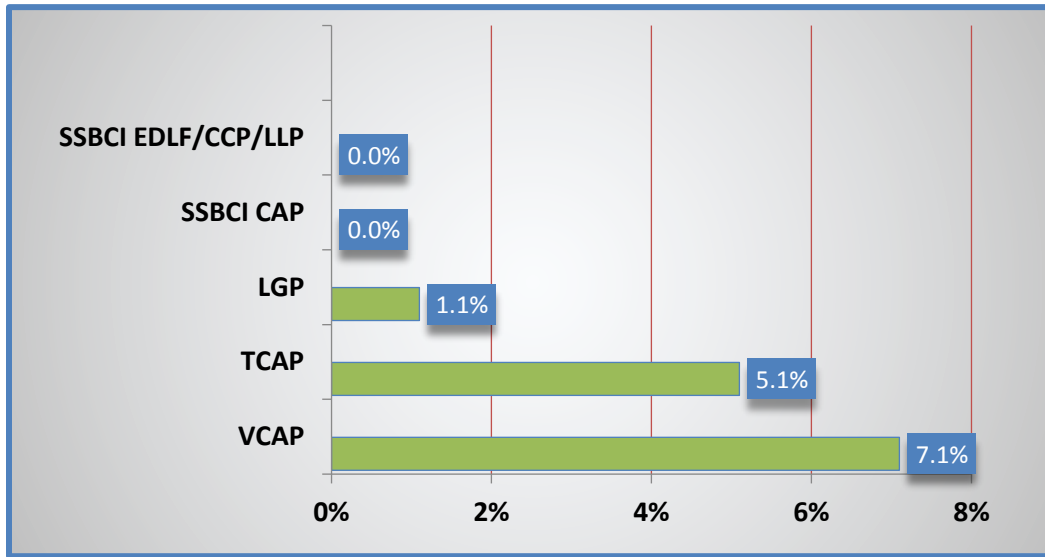
Source: Authority's Internal Loan Accounting System

Indirect Assistance Program Default Rates

Default rates since inception for indirect assistance programs remained constant or declined in fiscal year 2016, with the exception of the TCAP Program, which experienced an increase in the default rate of 0.4%. Chart 5 provides information on default rates since inception related to the Authority's indirect assistance programs.

Default Rates Since Inception for Indirect Assistance Programs

Chart 5



Source: Calculated from Authority Internal Records



Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

August 17, 2017

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable Robert D. Orrock, Sr.
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Virginia Small Business Financing Authority** (Authority) for the year ended June 30, 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions in the Commonwealth's accounting and financial reporting system, and the Authority's internal loan accounting system and records; review the adequacy of the Authority's internal controls; and test compliance with applicable laws, regulations, contracts, and grant agreements. The Authority transitioned to using the Commonwealth's new accounting and financial reporting system on February 1, 2016.

Audit Scope and Methodology

The Authority's management has responsibility for establishing and maintaining internal control and complying with applicable laws, regulations, contracts and grant agreements. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws, regulations, contracts, and grant agreements.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered significance and risk in determining the nature and extent of our audit procedures. Our review focused primarily on administration of loan and loan guaranty programs, including controls over cash receipting.

We performed audit tests to determine whether the Authority's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws, regulations, contracts, and grant agreements. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Authority's operations. We performed analytical procedures, including budgetary and trend analyses. We also tested details of transactions to achieve our objectives.

A nonstatistical sampling approach was used. Our samples were designed to support conclusions about our audit objectives. An appropriate sampling methodology was used to ensure the samples selected were representative of the population and provided sufficient, appropriate evidence. We identified specific attributes for testing each of the samples and when appropriate, we projected our results to the population.

Conclusions

We found that the Authority properly stated, in all material respects, the amounts recorded and reported in the Commonwealth's accounting and financial reporting System, and its internal loan accounting system and records. The financial information presented in this report came directly from the Authority internal system and financial records.

We noted no matters involving internal control and its operation that we consider necessary to be reported to management. The results of our tests of compliance with applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Exit Conference and Report Distribution

We discussed this report with management on August 23, 2017.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

PMK/alh

VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

As of June 30, 2016

Scott Parsons, Executive Director

BOARD OF DIRECTORS

Gail Letts, Chairman
Neil Amin, Vice Chairman

| | |
|-------------------|---------------------|
| Linh Hoang | Dr. Monique Johnson |
| John Hopper | Nicholas Jordan |
| Bradley Jiulianti | Andrew Lock |
| William Smith | |

Manju Ganeriwala, State Treasurer
Ex-officio voting member

Tracey Wiley, Director
Department of Small Business and Supplier Diversity
Ex-officio voting member